

RETIREMENT QUARTERLY

Employees Retirement System

July 2004



Actuarial Study for the Projection of Available Surplus

Once again, the Employees Retirement Board directed their actuary to prepare a special actuarial study to project available surplus for the next six years to determine the fiscal impacts to the City, active employees and retirees. The purpose of this study is to learn the effect on the System's surplus distribution under projected market returns over the next 6 years. The Board is providing this information to hopefully assist its members and retirees in understanding the investment market and its related impact. The Board believes that it is important to remember that your City of Fresno Employees Retirement System remains one of the **highest funded public retirement systems in the state of California** and that your pension Trust remains protected and financially sound.

- The Study projects the impact associated with the recognition of deferred market losses through June 30, 2003 and the deferral of future gains and losses. The amount of deferred losses as of June 30, 2003, using the three -year valuation asset smoothing method, was \$19.3 million for the System.
- The Study also utilizes the City's prepaid contributions to determine how long the City's contributions can be maintained at \$0.
- The Actuary has provided employer and employee contribution offsets and actual City contributions under the four market return scenarios.

The results of the actuary's special study projects the following potential impacts:

To the Retirees:

The actuary projects that the PRSB Reserve Fund can only fund the PRSB payments through calendar year 2004. Beginning in January 2005, the actuary projects surplus levels will not be sufficient to continue funding the PRSB benefit. Therefore, in January 2005, the PRSB benefit will likely cease until sometime in the future when the actuarial assets in the System exceed 110 percent of the System's actuarial liabilities, net of the City and active member COLA contribution requirements.

To the City:

In 2007, the City may have depleted the City Surplus Reserve and most of the prepayments from the Pension Obligation Bonds issued in 1994. It is projected that the City will begin to make substantial contributions amounting to approximately 61 percent of its total contribution rate (\$7.5 million) in 2007. In 2008, the

City will likely be at the 78 percent

see "Surplus" on page 4 ■

*"highest funded
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RETIREMENT BOARD ELECTIONS

At the July Retirement Board meeting, the Board conducted the annual election for Chair and Vice Chair. Bill Quick was re-elected as Chairman and Carla Lombardi was re-elected as Vice-Chair.

In March 2004, a Notice of Election was circulated among the Clerical and Supervisory Workers. The nomination petition was received and in June 2004, Frank H Balekian Jr. was certified and re-elected as the Clerical and Supervisory Member on the Employee Retirement Board.

City of Fresno
Retirement Office
2600 Fresno Street
Room 2162
Fresno, CA 93721
Tel: 559 621-7080
Fax: 559 621-7081
www.fresno.gov/Retirement/



DROP Rate Set for FY 2005

At the Employees Retirement Board meeting on July 21, 2004, the Board approved the Annual Net Effective DROP Interest Rate for fiscal year 2005 at 3.74 percent. The interest rate is based on the System's average net investment earnings over the prior five years.

The Employees Retirement Board is required under Fresno Municipal Code 2-1852 "Deferred Retirement Option Program" to annually adopt an annual effective DROP interest rate, which shall apply to each DROP account during the Retirement System's fiscal year in which the Board sets the rate. Because DROP has initially been determined to be cost neutral to the Retirement System, it is not necessary for the Board to consider any adjustments to the rate to maintain cost neutrality of the System for fiscal year 2005. The Board's actuary will be reviewing the cost neutrality of the program during the upcoming actuarial study of June 30, 2004.

Annual Member Contribution and DROP Statements Distributed

Active member contribution and DROP statements, as of June 30, 2004, have been distributed to the members. If beneficiary information contained on your statement is not correct, please complete the Change of Beneficiary form that was enclosed with your statement, or

- Call the Retirement Office at (559) 621-7080 and we'll send one to you, or
- Go to "System Forms" on the City of Fresno's Web Site at <http://www.fresno.gov/Retirement/>

For ACTIVE EMPLOYEES (NOT DROP MEMBERS): Your address information is downloaded from PeopleSoft. If your address information is not correct on your statement, please notify your division payroll clerk.

For ACTIVE DROP MEMBERS: You should notify the Retirement Office of any address change.



RETIREES and DROP Members

Effective July 1, 2004, a 1.6 percent COST-OF-LIVING (COLA) increase will be applied to all DROP members and retirees' benefits. The retirees' increase will first appear on the July 31, 2004 retirement benefit check.

Pursuant to Section 2-1840.4 of the Fresno Municipal Code, the Employees Retirement Board is required to determine on or before April 1 of each year, by reference to the Consumer Price Index (United States city average for urban wage earners and clerical workers) as published by the Bureau of Labor Statistics, the percentage of annual increase in the cost-of-living during the preceding calendar year.

DEFERRED COMPENSATION NEWS

SERVICE ENHANCEMENT UPDATE - PORTFOLIO REBALANCE

The Fidelity NetBenefits® Portfolio Rebalance service has been enhanced to make it even easier for participants to reallocate their workplace savings plan balances. This feature, which lets participants reallocate their entire account in one simple transaction, will now provide greater flexibility. And with added functionality, Portfolio Rebalance is available to even more workplace savings plans.



Enhancements to Portfolio Rebalance include:

- Refinements to plan investment display options to exclude closed or frozen funds for participants who don't currently have a balance.
- The ability to rebalance Fidelity Select Funds.
- Added flexibility to support plan-specific investment parameters, including the display of Fund Tiers and the ability to elect partial percentages.
- A simplified process for requesting/viewing fund prospectuses as well as an expanded selection of online prospectuses.

Benefits to your Plan:

- Greater access: participants have a new way to manage their account through one single transaction versus multiple exchanges.
- Improved participant asset allocation: This service makes it easy for participants to maintain a consistent, long-term investment strategy by rebalancing their portfolio to maintain their desired asset allocation.

Benefits to Participants:

- Greater convenience: Allows participants to manage their portfolio's asset through a single transaction.
- Flexibility and Control: For the "do-it-yourselfer" to reallocate their desired portfolio quickly and efficiently without having to calculate and enter individual exchanges.
- Investment Strategy: Participants can maintain a consistent, long-term investment strategy by rebalancing their portfolio to align it with their ideal investment mix.

If you have any questions, please contact Fidelity Investments at 1 (800) 430-2363.

CITY COUNCIL APPROVES NEW BOARD OF TRUSTEE STRUCTURE FOR DEFERRED COMPENSATION PLAN

On July 20, 2004, a public hearing was held before the City Council to adopt changes to the Deferred Compensation Plan document, as recommended by the Deferred Compensation Committee, to modify the City of Fresno Deferred Compensation Committee structure to a five-member Board.

In the current plan, the Deferred Compensation Committee structure consisted of representatives from the City Manager's Office, the City Attorney's Office and the City Finance Department. The City Attorney opined that having a representative from the City Attorney's Office as part of the Deferred Compensation Committee structure while the City Attorney acts as counsel for the Committee creates a potential conflict of interest. Upon review of several options, the Council requested that the Deferred Compensation Committee conduct a survey of the Plan participants. After reviewing the results of this survey, the Committee recommended the following composition for the

Deferred Compensation Board:

- ◆ two members appointed by the City Manager and confirmed by the Council (one member from the Finance Department and one member from any City Department)
- ◆ two members elected by and from the participants of the Plan who have a non-zero balance in the Deferred Compensation account (both active and retired participants would qualify.)
- ◆ a fifth member chosen by the other four members from qualified electors of Fresno County who have no connection with the Plan or the City of Fresno, preferably someone with investment knowledge and experience.

The Committee also recommended that the revised structure be referred to as the Deferred Compensation Board to conform with all other City Boards and in order to enhance the ability to recruit an outside member from the local financial community.

INVESTMENT REPORT

by Stanley McDivitt, Retirement Administrator

Status of Investment Committee Projects

The Investment Committee recently completed its evaluation of firms that provide Securities Litigation monitoring services. The Boards have retained the services of Investor Responsibility Support Services, Inc. (IRSS) in Media, Pennsylvania. IRSS will perform securities class action litigation review, monitoring and support services for the City of Fresno Retirement Systems, which will ensure that the Systems receive all the proceeds to which they are entitled from class action litigation settlements.

The Committee recently completed its analysis and search of large-cap enhanced equity managers. The Boards hired Barclays Global Investors (BGI) located in San Francisco to manage a large-cap enhanced equity index fund in the amount of approximately \$80 million. The Investment Committee recently completed its due diligence review of high yield fixed income managers and retained the firm of Loomis Sayles as a High Yield Fixed Income Manager. In the coming months, the Committee will be considering investment manager searches for real estate investment trusts and large-cap growth products.

The Economy

The Federal Reserve in June raised its interest rate target for overnight loans between banks for the first time in four years. The federal funds target rose .25% to 1.25% from a four-decade low of 1 percent. Consumer confidence appears to remain fairly strong despite a temporary slowing of consumer spending and reports that the economy is ranked as the No. 1 issue in this year's Presidential campaign.

Investment Performance of the Systems

For the current twelve months ending June 30, 2004 our System's cumulative investment returns were 17.70 percent. Our investment results remain solid with consistent annualized returns in excess of 10 percent over the past fifteen years. For the past five years the System's annualized return was 4.21% which compares very favorably with the five year return of the SP 500 return of -2.20%, the Russell 2000 Growth return of -0.45%, MSCI EAFE International Index return of 0.06 & and the Lehman Aggregate bond index of 6.95%.

As of June 30, 2004, the Retirement System's portfolio had 66.8 percent in equities, 25.0 percent in fixed income, 8.0 percent in an open-ended real estate investment fund and .2 percent in cash. The investments were further diversified into the following asset classes and target percentages:

Large-cap equities	34.8%
Small-cap equities	12.1%
International equities	16.6%
Emerging Market equities	3.3%
Domestic fixed income	25.0%
Real estate	8.0%
Cash	<u>0.2%</u>
Total	<u>100%</u>

This asset class diversification along with portfolio investment style diversification is all part of the Retirement Board's Investment Risk Management Program.

To Active Members:

Beginning in FY 2006, our actuary projects that active members will be required to pay approximately one-third of their COLA contributions. This means that an average member in the system will have to start contributing an additional 1.14% of his or her salary.

SUMMARY

We will keep you informed on this important issue. The Employees Retirement Board is providing this information to help you understand what has happened over the last four years and to allow PRSB recipients and active employees an opportunity to plan for the future. The PRSB program has been a great program for retirees, active employees and the City, but because the PRSB is contingent upon the availability of surplus earnings in the System, it would be prudent to immediately begin planning for the future with these changes in mind.

RETIREMENTS

January 1, 2004 to June 30, 2004

John Hutson
Jeanne Weaver
Olga Salazar
Richard Akens
Roy Bradley
Lindsay Green
Roger Burrow
Emily Ringer
Manuel Mancha
Allan Eldred
Fred Arreola
Jose Sanchez
Robert Cardoza
Connie Mehia

Larry Webster
Joyce Dunkle
John Harlan Jr.
Larry Harmon
Robert Holman
John Quintana
Lois Johnson
Joe Marquez
Larry Fane
Alvin Cowin
James Chow
Samuel Esquivel
Arnold Vasquez

